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IN THE

Supreme Court of the United States

October Term, 1981

F. W. WOOLWORTH CO., *Appellant*

v.

TAXATION AND REVENUE DEPARTMENT OF THE STATE OF NEW MEXICO, *Appellee.*

On Appeal from the Supreme Court of New Mexico

BRIEF OF AMICUS CURIAE STATE OF VERMONT IN SUPPORT OF APPELLEE'S BRIEF

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TABLE OF CONTENTS

Page

Table of Authorities ii

Introductory Statement 1

Statement of Interest 2

Summary of Argument 3

Argument 3

I. There Is No Due Process Bar To The Inclusion Of Dividends In The Taxable Income Of A Corporation Doing Business Within A State So Long As The Income Is Fairly Apportioned. 3

II. The Inclusion Of Dividends In Pre-apportioned Income Does Not Require Adjustment Of A State's Apportionment Formula To Reflect The Property, Payroll And Sales Of The Dividend Payor. 7

Conclusion 8

TABLE OF AUTHORITIES

CASES	PAGE(S)
Exxon Corp. v. Department of Revenue of Wisconsin, 447 U. S. 207 (1980)	3, 4
F. W. Woolworth Co. v. Commissioner of Taxes, 130 Vt. 544, 298 A.2d 839 (1972)	5
Ford Motor Co. v. Beauchamp, 308 U. S. 331 (1939)	7
Hans Rees' Sons v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931)	5, 8
Mobil Oil Corp. v. Commissioner of Taxes, 136 Vt. 545, 394 A.2d 1147 (1978), *aff'd* 445 U.S. 425 (1980)	5
Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980)	4, 5, 6, 7
Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978)	4, 8
Norfolk & Western Railway Co. v. Missouri State Tax Commission, 390 U.S. 317 (1968)	4
Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169 (1949)	4
Underwood Typewriter Co. v. Chamberlain, 245 U.S. 113 (1920)	6
Wisconsin v. J. C. Penney Co., 311 U.S. 435 (1940)	6

Page

VERMONT STATUTES

VT. STAT. ANN. TIT. 32, §5811(18) 2

VT. STAT. ANN. TIT. 32, §5832 2

VT. STAT. ANN. TIT. 32, §5833 2

VT. STAT. ANN. TIT. 32, §5833(b) 2

OTHER AUTHORITIES

Federation of Tax Administrators, Research Memorandum 527, Federal Starting Point Laws: State Personal and Corporate Income Taxes (November, 1981) 5

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INTRODUCTORY STATEMENT

This brief is submitted by the State of Vermont as amicus curiae in support of the Appellee. An identical brief has been submitted in support of the Appellee in *Asarco, Incorporated (formerly American Smelting and Refining Company) v. Idaho State Tax Commissioner, prob. jusis. noted,* No. 80-2015 (U.S. Oct. 5, 1981).

STATEMENT OF INTEREST

The State of Vermont imposes a tax on the net income of corporations doing business within the state. VT. STAT. ANN. TIT. 32, §5832 (1981). Vermont net income is calculated by using the current federal definition of taxable income, with some adjustments. *Id.* §5811(18). Because federal taxable income includes dividends from a corporation's foreign subsidiaries, such dividends are also included in Vermont's tax base.

When a corporation operates in other jurisdictions as well as in Vermont, an apportionment formula is applied to the corporation's income to determine "a fair and equitable portion" to be taxed by Vermont. *Id.* §5833. Vermont's apportionment formula is not automatically adjusted when dividends from foreign subsidiaries are received by a corporation taxed in Vermont, although the Commissioner of Taxes may modify the formula if it does not fairly represent the extent of a corporation's business activities in the state. *Id.* §5833(b).

Vermont has a direct and significant interest in the outcome of this case because it would be barred from including certain dividends in its tax base, or, alternatively, would be forced to modify its apportionment formula in certain cases, if the Appellant's Due Process and Commerce Clause arguments are upheld. Vermont's brief will discuss only the propriety, under the Due Process Clause, of including dividends in apportionable income and the necessity of modifying the apportionment formula if dividend income is included.

SUMMARY OF ARGUMENT

When a state imposes a tax on the income of a multinational corporation doing business within its borders, the only valid question under the Due Process Clause is whether the tax imposed is out of all proportion to the benefits conferred on the corporation by the state. The application of an apportionment formula to a corporation's operating and investment income is a reasonable method of apportioning profits among the states. Dividends, as part of a corporation's investment income, may be considered in ascertaining the profitability of a corporation and are apportionable under long-standing due process analysis.

As long as an apportionment formula produces a tax reasonably related to the activities of a corporation within the state, no modification to the formula to take into account the property, payroll and sales factors of a dividend payor is justified under the Due Process Clause.

ARGUMENT

I. There is no due process bar to the inclusion of dividends in the taxable income of a corporation doing business within a state so long as the income is fairly apportioned.

A state may tax the income of a corporation engaged in interstate commerce provided a minimal connection or "nexus" exists between the taxing state and the interstate activities of the corporation. *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 219 (1980). The nexus requirement is met if the corporation avails itself of the substantial privilege of carrying on

business within the state. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 437 (1980) (hereinafter cited as *Mobil*). Once nexus is established, "[s]o far as due process is concerned the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing state." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. 317, 325 n.5 (1968) (quoting *Ott v. Mississippi Valley Barge Line Co.*, 336 U.S. 169, 174 (1949)).

It is well established that, when a corporation does business within a state, the corporation receives the substantial benefits of a state's services, including "police and fire protection, the benefit of a trained work force, and 'the advantages of a civilized society.'" *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. at 228 (citations omitted). The application of a reasonable apportionment formula to the income of an interstate corporation ensures attribution of a portion of income to each state in direct relation to the corporation's activities within the state. Such an attribution is reasonable in light of the privileges afforded by the state to the operating corporation and is a guarantee that the proper value is placed on the state's services in relation to the corporation's profitability.

The proper focus of due process analysis is not what goes into the corporation's taxable income, but what the results are after a state's apportionment formula has been applied to that income. *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273-74 (1978). The source of a particular item of income is unimportant; the test is whether the tax assessed after application of the apportionment formula is in proportion to the benefits con-

ferred by the state. *Mobil*, 445 U.S. at 437; *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

In Vermont's view, both operating and investment income contribute to the overall corporate enterprise.[1] Where a portion of the total corporate business is being conducted in Vermont, it is appropriate to include all income in the tax base as long as it is properly apportioned. *See Mobil Oil Corp. v. Commissioner of Taxes*, 136 Vt. 545, 552, 394 A.2d 1147, 1151 (1978), *aff'd*, 445 U.S. 425 (1980); *F. W. Woolworth Co. v. Commissioner of Taxes*, 130 Vt. 544, 549, 298 A.2d 839, 841 (1972).

When a state extends its services to a corporation, it is providing an atmosphere in which a corporation may prosper, whether by extensive management of operating assets, manipulation of a market for its goods, or reinvestment of its profits. A corporation's income may include, in addition to operating income, long- and short-term investment income. Operating income represents the current profits of the company's active business, while investment income is a result of a temporary or long-term diversion of operating profits to investments available to, or supportive of, the operating business.

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1 Vermont and twenty-one other states employ the federal definition of income as the starting point for their corporate income taxes. Federation of Tax Administrators, Research Memorandum 527, Federal Starting Point Laws: State Personal and Corporate Income Taxes (November, 1981). The use of the federal income definition provides administrative convenience to the states because it is widely accepted and refined by many rulings, regulations and court opinions. Adherence to the federal definition results in consistency of treatment at the state level, offering predictability and uniformity, as both intrastate and interstate corporations will include the same items of operating and investment income.

When a state chooses to include an interstate corporation's investment income in determining its apportionable income, the state is not taxing extraterritorial values. *See Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-21 (1920). The investment income represents the income of the corporation which holds the investment; its inclusion is not an attempt by the state to tax the income of the operating business which produces the income for the investor. For example, inclusion in income of interest earned on bank certificates of deposit measures the investor's profitability; such inclusion is not an attempt to reach the bank's income. Similarly, the inclusion of dividends from a foreign corporation in the income of a corporate shareholder measures the investment profit of the shareholder; the inclusion is not an attempt to tax the foreign corporation's income.

While the Court in *Mobil* specifically reserved decision on the apportionability of dividends where there is no underlying unitary business as the source of the dividends, there was no real discussion in the opinion of the effect investment income has on the overall operations of a business. *Mobil*, 445 U.S. at 442. This Court has recognized that intangible property held by a multistate corporation contributes to the overall business carried on within each state:

> Financial power inherent in possession of assets may be applied, with flexibility, at whatever point within or without the state the managers of the business may determine. . . . The weight, in determining the value of the intrastate privilege, given the property

> beyond the state's boundaries, is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state.

Ford Motor Co. v. Beauchamp, 308 U.S. 331, 336 (1939).

The Court might well find that the "business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing state," *Mobil*, 445 U.S. at 442, and still find that the *dividends themselves* are used by the recipient in its business and are fully apportionable. As long as the results produced by an apportionment formula are fair, the amounts included in the apportionable base are beyond criticism under the Due Process Clause.

II. The inclusion of dividends in pre-apportioned income does not require adjustment of a state's apportionment formula to reflect the property, payroll and sales of the dividend payor.

As discussed above, due process analysis examines the privileges and protections invoked by a corporation when it does business within a state and what that state can ask in return by way of a corporate income tax. Both operating and investment income may be considered in measuring the tax a corporation should pay to a state, as long as the resulting tax bears a rational relationship to the activities conducted within the state. Since an apportionment formula spreads investment income among taxing states on the basis of operating factors (property, payroll and sales), the resulting tax is *per se* a reasonable extraction by each state.

A demand that the property, payroll and sales factors of a dividend-paying corporation be reflected in a state's apportionment formula is really a repetition of the argument that dividends should be excluded from income. If the source of income has no due process bearing because the result of apportionment is what is to be considered, then the factors of the dividend-paying corporation are irrrelevant unless the result of apportionment is unfair. Showing that a corporation would pay less tax if the factors of the dividend-paying corporation were considered does not prove that the apportionment formula is unfair; an inclusion in income of interest from a bank certificate of deposit would not call for a modification of an apportionment formula to reflect the bank's factors, although such an action would surely reduce the operating company's tax. What must be shown is that the tax is out of all proportion to the benefits received. *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 274; *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. at 135. The Appellant has failed to show that the tax imposed exceeded the benefits conferred and was unfair. Absent proof of such unfairness, the apportionment formula must be upheld.

CONCLUSION

The Due Process Clause requires only that a corporation have a minimal connection with a state before a tax on income may be imposed. The apportionment of a multistate corporation's income guarantees that the tax imposed will be reasonably related to the activities of the corporation within the state. Dividend income may be included in the income subject to apportionment because it reflects the profits of the entire corporate enterprise

which is carried on, in part, within the state. No modification of the apportionment formula is required where dividends are included in apportionable income unless the formula produces an unfair result, out of all proportion to the benefits received by the operating company.

Dated at Montpelier, Vermont, this 15th day of January, 1982.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of January, 1982, three copies of this brief were mailed, with first class postage prepaid, to George W. Beatty, 1200 18th Street, N.W., Washington, D.C. 20036, Counsel for Appellant, and to Sarah E. Bennett, Post Office Box 630, Sante Fe, New Mexico 87509, Counsel for Appellee. I further certify that all parties required to be served have been served.

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